

SUPREME COURT, U. S. IN THE

Supreme Court of the United States 9 1975

October Term, 1974

Supreme Court, U. S.
FILED
MICHAEL RUDAK, JR., CLERK

Nos. 74-157 and 74-647

UNITED HOUSING FOUNDATION, INC., *et al.*,
Petitioners,

v.

MILTON FORMAN, *et al.*,
Respondents,

and

THE STATE OF NEW YORK and THE NEW YORK
STATE HOUSING FINANCE AGENCY,
Petitioners,

v.

MILTON FORMAN, *et al.*,
Respondents.

**BRIEF FOR PETITIONERS UNITED HOUSING
FOUNDATION, INC., *et al.*, IN REPLY TO
THE BRIEF FOR THE SECURITIES AND
EXCHANGE COMMISSION AS
*AMICUS CURIAE***

SIMON H. RIFKIND
345 Park Avenue
New York, New York 10022
(212) 644-8602

Attorney for Petitioners
United Housing Foundation, Inc., et al.

MARTIN LONDON
GEORGE P. FELLEMAN
MARSHALL BEIL
CAROL GOODMAN
ALAN G. BLUMBERG
Of Counsel

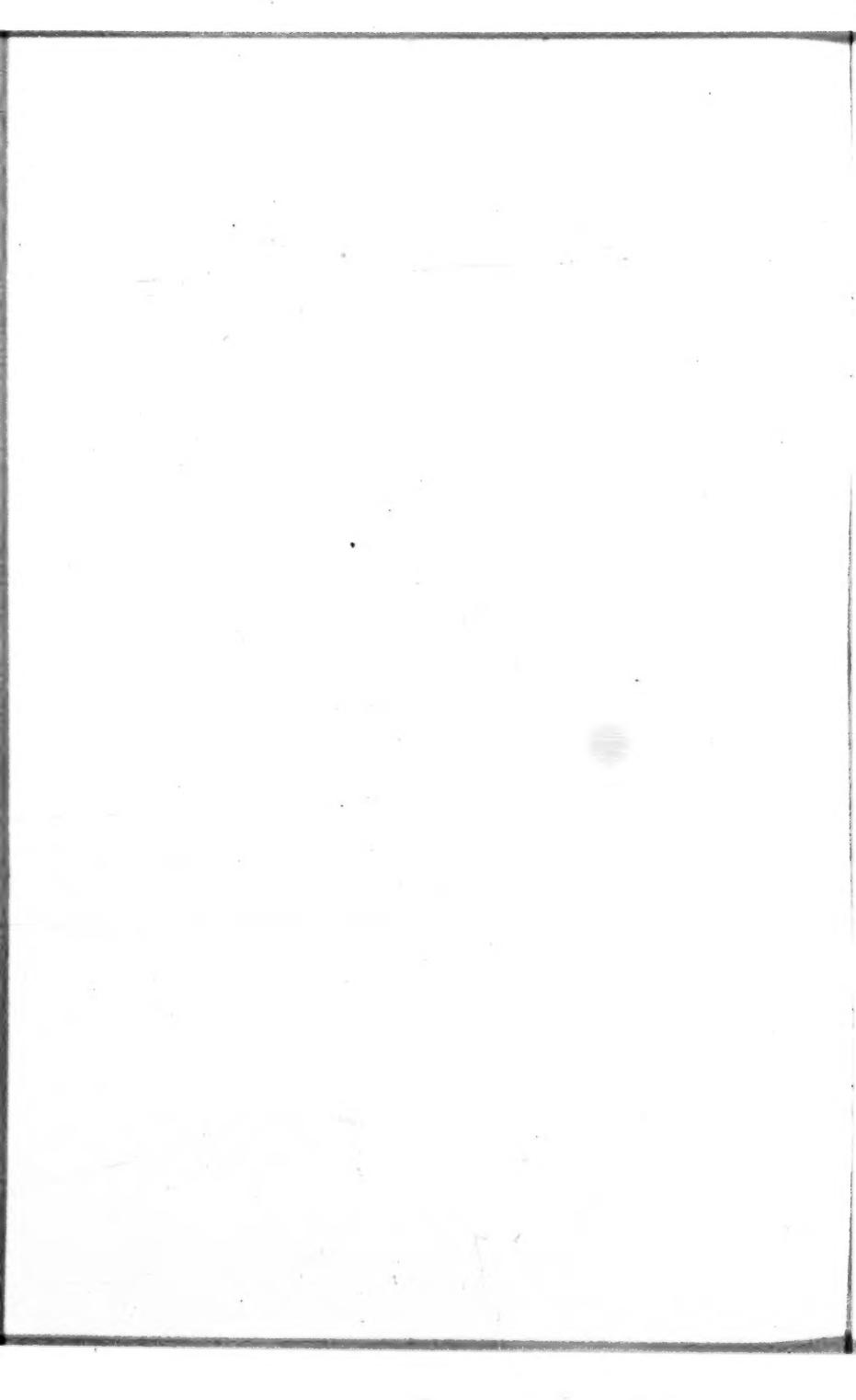


TABLE OF CONTENTS

	PAGE
1. The Facts	2
2. The Literal Approach	3
3. Investment Contract	4
4. Release 5347	5
5. Rule 235	8
6. No-Action Letters	10
7. Recent Legislation	11
Conclusion	12

TABLE OF AUTHORITIES

PAGE

Cases:

Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418 (1972)	7
SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943)	3, 5
SEC v. Glenn W. Turner Enterprises, Inc., 348 F.2d 766 (D.Ore. 1972), <i>aff'd</i> 474 F.2d 476 (9th Cir.), <i>cert. denied</i> , 414 U.S. 821 (1973)	5
SEC v. W.J. Howey Co., 328 U.S. 293 (1946)	4-5, 6, 7
Tcherepnin v. Knight, 389 U.S. 332 (1967)	5

Statutes and Rules:

Housing and Urban Development Act of 1974, Section 821, 42 U.S.C. §3532 (U.S.C.A. 1975 Supp.)	11
Real Estate Settlement Procedures Act of 1974, P.L. No. 93-533 (Dec. 22, 1974)	12
Section 3(1)	12
Securities Act of 1933, Section 3(b), 15 U.S.C. §77c(b)	8, 9
Tax Reduction Act of 1975, P.L. 94-12 (Mar. 29, 1975)	12
17 C.F.R. 202.1(d)	10
SEC Rule 235, 17 CFR 230.235	8-9, 10
Supreme Court Rule 42	1

SEC Releases and No-Action Letters:

Release:

SEC Securities Act Release No. 5347 (Jan. 4, 1973)	5-7
---	-----

No-Action Letters:

Clemson Properties, Inc., SEC No-Action Letter, Aug. 13, 1971, [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,387	11
900 Park Avenue Corp., SEC No-Action Letter, June 9, 1972 (avail. July 10, 1972)	8
Society Hill Towers, Inc., SEC No-Action Letter, Dec. 27, 1974, CCH Fed. Sec. L. Rep. ¶80,103	9
Stoneridge Golf and Country Club, SEC No-Action Letter, Jan. 3, 1975 (avail. Feb. 2, 1975) <i>also noted in BNA Sec. Reg. L. Rep. No. 289 at C-1-2</i> (Feb. 12, 1975)	10-11
Summit House Tenants Corp., SEC No-Action Letter, Jan. 6, 1972, [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,611	8-9

IN THE
Supreme Court of the United States
October Term, 1974

Nos. 74-157 and 74-647

UNITED HOUSING FOUNDATION, INC., *et al.*,
Petitioners,

v.

MILTON FORMAN, *et al.*,
Respondents,
and

THE STATE OF NEW YORK and THE NEW YORK
STATE HOUSING FINANCE AGENCY,
Petitioners,

v.

MILTON FORMAN, *et al.*,
Respondents.

**BRIEF FOR PETITIONERS UNITED HOUSING
FOUNDATION, INC., *et al.*, IN REPLY TO
THE BRIEF FOR THE SECURITIES AND
EXCHANGE COMMISSION AS
*AMICUS CURIAE***

This brief is submitted in reply to the brief for the Securities and Exchange Commission (SEC) as *Amicus Curiae*, which was served upon petitioners on April 17, 1975.*

* Rule 42 of the Rules of this Court required the SEC to file its brief on April 5, 1975. The SEC furnished petitioners with copies of unrevised page proofs of its brief on the evening of April 14, 1975.

That brief merely repeats arguments already advanced by the respondents. It does not present additional facts or legislative or administrative history and does not objectively analyze the relevant authorities. It evidences an unfamiliarity with the record below and presents arguments inconsistent with the SEC's previously expressed views as to the applicability of the federal securities laws to group-owned housing units.

We will not reiterate the arguments we have already presented in detail. We confine ourselves instead to pointing out how the SEC brief fails to deal squarely and openly with the issues before this Court.

1. The Facts

The SEC repeatedly refers to Co-op City's 15,000 members who invested approximately \$33,000,000 in the project (SEC Br. 1, 3, 5, 13). But the size of the project, we submit, has no bearing upon the jurisdictional question which this Court has been asked to decide. The law applicable to the question whether a Co-op City membership is a security under federal law is precisely the same whether one or one thousand memberships were sold.

In addition, the brief repeatedly emphasizes that Co-op City memberships were sold "upon the promise of significant economic benefits" (SEC Br. 2); were offered to the public "as an 'investment' opportunity" (SEC Br. 5); that "significant economic inducements are held out to investors" (SEC Br. 6, 14); and that "Petitioners' sales literature repeatedly emphasized the 'investment' or 'equity investment' nature of the offering . . ." (SEC Br.

9). Such characterizations are flatly contradicted by the record. Neither court below found such inducements or representations, and the Information Bulletins distributed to the respondents clearly described not the sale of an investment opportunity, or the lure of economic return, but the opportunity to live in a stable, attractive, cooperative community democratically controlled by the residents.* Curiously, the SEC fails to mention anywhere in its brief that Co-op City memberships cannot be resold at a profit.

2. The Literal Approach

The SEC brief adopts the "literal approach" advanced by the respondents. It argues that Co-op City memberships are "securities" because they are embodied in documents called "stock."

In urging this conclusion, the SEC fails to deal objectively with the relevant cases. For example, it contends that "documents are included within the definition of a security 'if on their face they answer to the name or description' *Securities and Exchange Commission v. C. M. Joiner Leasing Corporation*, 320 U.S. 344, 351 [sic]" (SEC Br. 7). But an examination of the opinion in *Joiner* indicates that this Court did not say that "documents are included" but that they "may be included" By changing the words "may be included" to "are included,"

* The SEC has made many errors in its recitation of the facts, and we shall not review them in detail. By way of example, the brief notes that the respondents "received certificates denominated as Riverbay 'stock'" (SEC Br. 3), when even a cursory reading of the record or of the opinions below would have indicated that no membership stock has yet been distributed. Moreover, the brief seriously misdescribes the allegations in the complaint (SEC Br. 4), and incorrectly characterizes rent rebates as "dividends from any surplus corporate earnings." *Id.* (See UHF Reply Br. 9).

the SEC substantially altered the meaning of the statement.

Similarly, the SEC has dealt less than candidly with the many Circuit Court decisions which have held a variety of "notes" not to be securities, despite the fact that the act defines "any note" as a security. Rather than addressing the conflict between the "literal approach" and the "note" cases, or advising the Court whether it disagrees with the "note" cases or perceives a substantial and significant reason for distinguishing them, the SEC simply states, in a footnote, that those cases "are unusual" (SEC Br. 8 n. 6).*

The SEC's reference to this Court's words in *Joiner* to the effect that promoters' offerings should be judged as being what they are represented to be (SEC Br. 9) does not advance the SEC's position. The record below demonstrates that petitioners were offering respondents housing, not investment opportunities.**

3. Investment Contract

The SEC also contends that Co-op City memberships fall within the traditional investment contract guidelines set down by this Court in *SEC v. W. J. Howey Co.*, 328

* The suggestion that notes may be of a more variable character than "stock" (SEC Br. 8 n. 6) is as inaccurate as it is unpersuasive. The difference between shares of General Motors stock and Co-op City memberships is at least as great as the difference between notes which are securities and notes which are not.

** The SEC claim that the New York Blue Sky Law is relevant to a federal law determination (SEC Br. 9 n. 8) is wrong. As pointed out in our reply brief at pages 14-15, New York has a separate statute dealing specifically with real estate offerings, including cooperatives, condominiums and other forms of real estate syndications.

U.S. 293 (1946), *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943), and *Tcherepnin v. Knight*, 389 U.S. 332 (1967). But each of those cases involved the investment of money for the purpose of making profits, as that term is ordinarily understood in commerce. The investors in *Howey* were:

“attracted by the expectation of substantial profits. It was represented, for example, that profits during the 1943-1944 season amounted to 20% and that even greater profits might be expected during the 1944-1945 season. . . .” 328 U.S. at 296.

Similarly, in *Joiner*, the oil and gas leases were sold on the basis of substantial economic inducements. Indeed, as the Court noted:

“Had the offer made by defendant omitted the economic inducements of the proposed and promised exploration well, it would have been a quite different proposition.” 320 U.S. at 348.

Equally inapposite is the SEC's reliance on language in the District Court decision in *Securities and Exchange Commission v. Glenn W. Turner Enterprises, Inc.*, 348 F. Supp. 766 (D. Ore. 1972), *aff'd* 474 F. 2d 476 (9th Cir.), *cert. denied* 414 U.S. 821 (1973) (SEC Br. 12). That case involved a pyramid franchising scheme promising great riches through investment in the defendant's operations.

4. Release 5347*

The SEC fails entirely to come to grips with the contradiction between the view it expressed in Securities Act Release No. 5347 (*see* UHF Br. 36, UHF Reply Br. 19-21)

* The full text of the Release is set forth in Appendix D to the Petition for Certiorari in No. 74-157.

and the position it advances in this case. With respect to that Release, the SEC offers only the following comment in a footnote:

"The Commissioner's release relating to condominiums (Securities Act Release No. 5347, 38 Fed. Reg. 1735), relied upon by petitioners, was a statement to the public and the real estate industry that offerings of real estate, especially resort real estate, may, under some circumstances, constitute securities. The release was not intended to set forth an all-encompassing standard for real estate of every description, and that release is in no way involved under the circumstances of this case." (SEC Br. 22 n. 29).

The Release, which by its terms applies to condominiums and similar units in real estate (P-D 6-7), does not simply say that such units "may, under some circumstances, constitute securities." The Release sets forth specific guidelines as to when units are securities and when they are not:

"The offer of real estate as such, without any collateral arrangements with the seller or others, does not involve the offer of a security. When the real estate is offered in conjunction with certain services, a security, in the form of an investment contract, may be present." (P-D 7).

As previously described (UHF Br. 36-38), Release 5347 would treat such units as securities under the *Howey* investment contract test only when they are coupled with a profit-making arrangement such as a rental pool. Incidental income from commercial facilities, routine income tax deductions available to all home owners, and the benefits of home ownership are not, according to the Release, the kinds of "profit" which would make such real estate

units investment contract securities as defined in *Howey*. Indeed, the purpose of the Release was to separate sales of housing from sales of investment opportunities.

By relegating Release 5347 to a footnote, and then emasculating it in that footnote, the SEC effectively obscures the substantial inconsistencies in its arguments. If personal economic benefit derived from home ownership is an investment profit within the definition of a security set forth by this Court in *Howey*, why is this same economic benefit not considered an investment profit in Release 5347? If Co-op City's so-called profit elements make its cooperative memberships securities under the *Howey* formula, why are those same elements insufficient to meet the same *Howey* formula when the housing is a condominium? The SEC brief is silent on these questions, even though the parties and the Court might have been helped by a thoughtful explanation of the SEC's rationale for distinguishing between the economic benefit derived from ownership of a cooperative home and the economic benefit derived from ownership of a condominium home. Certainly, the cryptic statement in a footnote that Release 5347 "is no way involved under the circumstances of this case" (SEC Br. 22 n. 29) is of no assistance.

This is not the first time the SEC has advocated positions in this Court which are inconsistent with its previously published views. In *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 426 (1972), this Court rejected the SEC's interpretation of Section 16(b) of the 1934 Act and pointedly noted that the position advocated by the SEC in that case was flatly contradicted by its own previous constructions of the Act.

5. Rule 235

The SEC's passing reference to SEC Rule 235 fails adequately to deal with its past treatment of housing cooperatives, a treatment which is also inconsistent with the position it now advances in this Court.

In 1961, purportedly pursuant to Section 3(b) of the 1933 Act, the SEC adopted Rule 235, which exempts certain offerings of housing cooperative memberships from the registration requirements in the 1933 Act. Section 3(b), as originally enacted, allowed the Commission to exempt "securities" under certain circumstances so long as "the aggregate amount at which such issue is offered to the public" does not exceed \$300,000.* As required by Section 3(b), Rule 235 was limited to cooperatives where the "aggregate offering price" of all "securities" issued within a one year period did not exceed \$300,000. However, Rule 235(e) provides a curious escape valve by permitting computation of "aggregate offering price" on the basis of the "par or stated value" of the memberships.

Thereafter, in No-Action Letters, the SEC consistently held that the \$300,000 limitation in Rule 235 applied only to the par value of the memberships offered and not to their actual selling price. Accordingly, offerings as large as \$12,000,000 were treated as exempt, so long as the par value of the memberships was kept below \$300,000. See, e.g., *900 Park Avenue Corp.*, SEC No-Action Letter, June 9, 1972 (exemption of offering totaling \$11,896,000); *Summit House Tenants Corp.*, SEC No-Action Letter, Jan. 6,

* The section has since been amended to increase the amount to \$500,000.

1972, [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,611 (exemption of offering totaling \$4,279,293).

Thus, the combined effect of Rule 235 and the SEC's No-Action Letters was exemption from registration of all cooperative offerings, regardless of size. Such exemptions could not have been lawfully granted under Section 3(b) of the 1933 Act if cooperative memberships were "securities." The practice of exempting all cooperatives continued until six months after the decision of the Court of Appeals below. The SEC then announced in *Society Hill Towers, Inc.*, SEC No-Action Letter, Dec. 27, 1974, CCH Fed. Sec. L. Rep. ¶80,103, that it was "re-examining" its past practices in light of the decision that Co-op City shares were securities.

Clearly, during all of the years prior to the decision below, the SEC knew that Section 3(b) limited its power to exempt offerings of "securities" to those "offered to the public" for less than \$300,000. Clearly, it knew that its use of par value to measure "offering price" was artificial and could be manipulated at will by a seller of cooperative memberships.

And just as clearly, the SEC knew during all those years that it could not lawfully exempt offerings of millions of dollars of what it now calls "securities" if, in fact, they were "securities."

6. No-Action Letters

To avoid meeting these (and other) problems raised by its past practices, the SEC simply disclaims responsibility for No-Action Letters which it has issued, stating:

“Nor can the ‘No Action’ letter to which petitioners refer be taken as a statement of general policy. Because such letters represent only the views of the staff, and then only with respect to an enforcement posture in a particular case, they have no precedential value. In any event, the views expressed by Commission staff do not necessarily reflect the views of the Commission, 17 CFR 202.1(d) [sic]” (SEC Br. 22-23 n. 29).

Would the SEC have us believe that the “Commission” was unaware of, or disagreed with, the many No Action Letters issued by the “staff” under Rule 235? Is it suggesting that the “staff” was violating the 1933 Act in broadly exempting all housing cooperatives from the reach of the Act’s registration provisions? The SEC brief is silent on these questions.

In addition to No Action Letters under Rule 235, the SEC also fails to address the problems raised by other no-action letters it has issued. It does not state which, if any, of the many letters cited by both petitioners and respondents do state the position of the SEC, which do not, and what action, if any, has been taken or contemplated by the SEC to correct those that do not reflect SEC policy. For example, it would have been helpful for the SEC to explain why the “staff” decided that the certificates in *Stoneridge Golf and Country Club*, SEC No-Action Letter,

Jan. 3, 1975, were not securities, or whether the "Commission" now disagrees with the views as to profit on resale which the "staff" expressed in that letter, written less than four months ago.* Similarly, it would have been helpful in clarifying the issues in this case if the "Commission" had explained to the Court why the "staff" decided that the instruments in *Clemson Properties Inc.*, SEC No-Action Letter, Aug. 13, 1971, [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶78,387, were not securities even though the offering included instruments called "stock"? Instead, all we hear is a sweeping disclaimer of responsibility.

7. Recent Legislation

The SEC also fails to answer directly petitioners' references to recent legislation in the housing field. Petitioners did not argue, as suggested by the SEC, that the existence of federal housing legislation "bars" the application of the securities laws in this case. Rather, we argued that Congress has never indicated that transactions in cooperative homes are covered by the securities laws, and that recent federal enactments in the housing field support the view that Congress did not intend the securities laws to cover condominium or cooperative housing. This is made clear by Section 821 of the Housing and Urban Development Act of 1974, 42 U.S.C. §3532, which directs HUD to conduct a study of the problems in cooperative and condominium housing and to determine whether federal legislation is needed. The SEC's statement that Section 821 does not change existing law (SEC Br. 19-20) simply begs the ques-

* See UHF Br. 27 n. 22.

tion. The point is that passage of such legislation reinforces the conclusion that Congress is considerably less confident than the SEC that the securities laws do, or should, cover cooperative and condominium housing.

Likewise, the SEC's reference (SEC Br. 19) to the Real Estate Settlement Procedure Act of 1974, P.L. No. 93-533 (Dec. 22, 1974) ("RESPA"), misreads petitioners' brief. We referred to that statute as an indication of Congressional understanding that cooperative and condominium homes, and individual houses, are alike and should be treated alike, a view recently buttressed by their similar treatment in the Tax Reduction Act of 1975, P.L. 94-12, Mar. 29, 1975.*

Conclusion

The SEC has failed adequately to consider the questions raised by petitioners. Instead of addressing critical issues directly, it avoids them. Instead of explaining inconsistencies in past actions and policy statements, it dismisses them as irrelevant or as "staff" statements not binding on the "Commission." Accordingly, we respectfully submit

* The SEC errs in describing RESPA as intended only to aid individuals in closing federally-related mortgage transactions rather than to protect them from fraudulent misrepresentations in the sale of stock. RESPA was enacted for the purpose of preventing fraud in the sales of homes. Moreover, the term "federally related" is defined in the Act to include virtually every mortgage loan made, RESPA §3(1), which makes it applicable to every purchase of a Co-op City membership where the purchaser borrows any portion of the purchase price from a bank.

that the present views of the SEC as expressed in its brief are entitled to little consideration in this Court's deliberations.

Dated: New York, New York
April 18, 1975.

Respectfully submitted,

SIMON H. RIFKIND
345 Park Avenue
New York, New York 10022
(212) 644-8602

Attorney for Petitioners
United Housing Foundation, Inc., et al.

MARTIN LONDON
GEORGE P. FELLEMAN
MARSHALL BEIL
CAROL GOODMAN
ALAN G. BLUMBERG

Of Counsel